

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Correa Analyst: Kristina E. North Bill Number: AB 727

Related Bills: See Prior Analysis Telephone: 845-6978 Amended Date: June 3, 2002

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Agricultural Product Donations to Food Bank Credit/FTB Report to Legislature Regarding Credit Utilization

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 22, 2001, and amended May 9, 2001.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- _____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- _____ FURTHER AMENDMENTS NECESSARY.
- _____ DEPARTMENT POSITION CHANGED TO _____.
- ☒ REMAINDER OF PREVIOUS ANALYSES OF BILL AS INTRODUCED February 22, AND AMENDED May 9, 2001, STILL APPLY.
- _____ OTHER - See comments below.

SUMMARY

This bill would create a credit for taxpayers that donate agricultural products to food banks.

SUMMARY OF AMENDMENT

The June 3, 2002, amendments would:

- ♦ limit the credit to the donation of agricultural products to food banks located in Fresno County, Orange County, and Santa Cruz County; and
- ♦ delay the operative date so that the credit would apply to taxable years beginning on or after January 1, 2004, and before January 1, 2009.

The June 3, 2002, amendments resolved the technical concern raised in the department's prior analyses by eliminating unnecessary language regarding the division of the credit. Except for the changes discussed above and the new revenue estimate, the remainder of the department's analyses of the bill as introduced February 22, 2001, and amended on May 9, 2001, still apply. The policy concern has been provided below for convenience.

POSITION

Support.

On June 27, 2001, the Franchise Tax Board voted 2-0 to support this bill as amended May 9, 2001.

Board Position:

<input checked="" type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input type="checkbox"/> PENDING

Legislative Director

Date

Brian Putler

6/28/02

FEDERAL/STATE LAW

Under **current federal and state laws**, generally all ordinary and necessary expenses of a trade or business are deductible. For taxpayers required to use an inventory method of accounting, certain business expenses are deducted as part of their costs of goods sold. Inventories include all goods that are held for sale in the ordinary course of business or that are to become a physical part of goods for sale to customers in the ordinary course of business.

Farmers must use one of four methods to value inventory: 1) the cost method; 2) the lower-of-cost-or-market method; 3) the farm price method; and 4) the unit-livestock-price method. The two most commonly recognized methods of valuing inventories are cost and the lower-of-cost-or-market whichever is lower. Costs of goods on hand at the start of an accounting period are the amount at which they were valued in the closing inventory of the prior period. Costs of goods ordinarily purchased are the invoice price minus trade or other discounts. Costs of goods produced by the taxpayer include raw materials and supplies entering into or consumed in manufacturing, regular and overtime direct labor costs, and certain required indirect costs.

Under **current federal and state laws**, a taxpayer may claim a deduction for charitable contributions made to qualified organizations. A charitable contribution is a gift given to or for the use of a qualified organization. It may be in the form of money or property, or unreimbursed out-of-pocket expenses incurred by the taxpayer for services rendered to the organization. Thus, if a donor donates agricultural products to a qualified organization for federal and state tax purposes, the donor may currently take an itemized deduction for the contribution under federal and state tax purposes.

Current state law also provides a credit equal to 50% of the transportation costs paid or incurred for transporting any donated agricultural product to a nonprofit charitable organization.

THIS BILL

This bill would allow a credit equal to 10% of the normal inventory costs for the donation of an agricultural product made to a food bank.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, potential revenue losses are projected to be very minor (on the order of \$250,000 annually) beginning with fiscal year 2004/2005.

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

Revenue Discussion

Revenue losses would be determined by the inventory costs of donated agricultural products to food banks in the three specified counties and the amount of credits that are applied in any given tax year against available tax liabilities of donors.

According to data from the California Department of Food and Agriculture, the three qualified counties yield 14% of the 2000 statewide gross value of agricultural products. Applying this rate to the prior revenue projection for this bill (as introduced February 22, 2001), potential revenue losses are projected to be on the order of \$250,000 annually with the deduction offset applied. It was also anticipated that agricultural product donations from other California counties to food banks in the qualifying counties would be insignificant due to higher donors' expenses (transportation, etc.).

The prior estimate was based on actual state data for the previous 10% tax credit (tax years 1989 through 1991).

POLICY CONCERN

Farmers generally would not be required to use the inventory cost method. Costing inventory is a complex procedure. Four separate costing methods exist, each with its own intricate set of rules. As a result, some targeted taxpayers may choose not to claim this credit. See Attachment 1 for further discussion.

LEGISLATIVE STAFF CONTACT

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Attachment 1

AB 727 – Calculation of Agricultural Product Donation Credit

Basic Explanation and Example:

The credit would be calculated by adding the total costs (direct and indirect) of the donated agricultural products and multiplying that amount by 10%.

For example, a taxpayer decides to donate 100 crates of oranges to a local food bank. The taxpayer calculates his credit as follows:

Direct cost of producing and packaging one crate of oranges:

Irrigation	\$1.00
Fertilizer	\$1.00
Pesticides	\$1.00
Labor	\$1.00
Storage	<u>\$.50</u>
<i>Total Direct Costs</i>	\$4.50

Indirect cost allocable to one crate of oranges:

Administrative	\$.25
Interest	\$.15
Taxes	<u>\$.10</u>
Total Indirect Costs	\$.50

Total costs for one crate of oranges = \$4.50 + \$.50 = **\$5.00**

Total costs of donation using the cost method of determining inventory = \$500 (100 crates x \$5.00)

Total credit amount for donating 100 crates of oranges to a food bank = **\$ 50** (\$500 x 10%)

Technical Explanation

AB 727 would require the taxpayer to use the cost method of valuing inventory to determine the value of the taxpayer's donation and the subsequent credit. Basically, the **cost method** (as illustrated by the example above) includes all costs directly related to the production of the inventory in addition to the appropriate share of indirect costs.

The direct and indirect costs describe above are not to be interpreted as being exclusive. Direct costs include materials, equipment, and labor directly related to the production of the inventory. Indirect costs, part or all of which are allocable directory to the inventory, include taxes, interest, and other related administrative expenses.